

CIVIL AND CRIMINAL TAX PENALTIES  
**IMPORTANT DEVELOPMENTS - CRIMINAL**

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Important Criminal Tax Developments

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## THE *STEIN* (KPMG) CASE

*Stein* (KPMG) ([www.usdoj.gov/usao/nys/pressrelease2005](http://www.usdoj.gov/usao/nys/pressrelease2005))  
*United States v. Jeffrey Stein, et al.*, 05 CRIM. 888 (S.D.N.Y.)

### **Background**

On October 17, 2005, the government filed a superseding indictment in *United States v. Jeffrey Stein, et al.*, adding 10 additional defendants to what is billed as “the largest criminal tax case ever filed.” Press Release (October 17, 2005), United States Attorney, Southern District of New York. The defendants include the former Deputy Chairman of KPMG, several former heads of KPMG’s Tax Practice, the former CFO of KPMG, the former head of KPMG’s Department of Professional Practice, a former KPMG Associate General Counsel, a former tax partner of a prominent national law firm, and numerous other KPMG tax partners. The 19 defendants are charged with conspiracy to defraud (18 U.S.C. § 371), tax evasion (26 U.S.C. § 7201), and obstruction (26 U.S.C. § 7212), for devising, marketing, and implementing fraudulent tax shelter schemes, which generated at least \$11.2 billion in phony tax losses. KPMG is not a defendant in the *Stein* indictment, having executed a deferred prosecution agreement, available at [www.usdoj.gov/usao/nys/pressrelease2005](http://www.usdoj.gov/usao/nys/pressrelease2005).

In furtherance of this tax shelter fraud, the defendants allegedly issued opinion letters containing false representations that the tax shelter losses would “more likely than not” survive IRS challenge, as well as other false documentation regarding the tax shelter transactions. The superseding indictment also alleges that the defendants fraudulently concealed the tax shelters from the Service by failing to register the tax shelters and by preparing tax returns that fraudulently concealed phony losses. The government alleges that the defendants obstructed the IRS and United States Senate investigations into their tax shelter scheme by: (1) attempting to conceal documents and information with sham attorney-client privilege claims; (2) failing to turn over requested documents; and (3) falsely testifying before both the IRS and Senate.

In *United States v. Stein, et al.*, 435 F.Supp.2d 330 (S.D.N.Y. 2006) (June 26, 2006), Judge Lewis Kaplan ruled that the government unconstitutionally pressured KPMG not to pay legal fees for the defendants. “Those who commit crimes – regardless of whether they wear white or blue collars – must be brought to justice. The government, however, has let its zeal get in the way of its judgment. It has violated the Constitution it is sworn to defend.” *Id.* at 336. Judge Kaplan noted that while the government did not literally request or direct that KPMG do anything with respect to the legal fees, it was clear that “KPMG refused to pay because the government held the proverbial gun to its head.” *Id.*

In the earlier stages of the investigation, and in an attempt to demonstrate cooperation and avoid prosecution, KPMG put significant pressure on its employees, using legal fees as leverage. According to a form letter KPMG sent to counsel for its employees and to the government, the firm authorized \$400,000 in fees for employees willing to cooperate, and failure to cooperate or being charged with a crime resulted in nothing. Judge Kaplan also pointed to the Memorandum from Deputy Attorney General Larry D. Thompson to Heads of Department Components and United States Attorneys, Re: Principles of Federal Prosecution of Business

Organizations (Jan. 20, 2003), which advises prosecutors to grant more lenient treatment to firms under criminal investigation if they stop paying legal fees on behalf of potentially culpable employees.

Judge Kaplan stopped short of dismissing the charges or ordering the government to pay the legal fees, which would literally require an act of Congress, but said the defendants could proceed against KPMG in an ancillary civil action, over which he would preside and move expeditiously. He suggested that KPMG should pay the fees to avoid “more unpalatable relief” being granted to the defendants.

*In United States v. Stein, et al.*, --- F.Supp.2d ---, 2006 WL 2556076 (S.D.N.Y.) (September 6, 2006), the criminal defendants filed suit against KPMG seeking advancement of legal defense costs, and KPMG filed a motion to dismiss for lack of subject matter jurisdiction and on the merits. In particular, KPMG argued that the defendants are obliged, by the terms of their employment contracts, to arbitrate these claims. KPMG further argued that the claims by some of the defendants were foreclosed by the partnership agreement or released.

Judge Kaplan held that the district court had ancillary jurisdiction over the advancement claim. He further held that, assuming the existence of a valid arbitration agreement regarding the claim, the enforcement of any such agreement would violate public policy by compromising the court’s ability to ensure a speedy trial, protect the public interest by avoiding possible dismissal of the criminal charges, safeguard the defendants’ rights to a fundamentally fair trial, and seek to avoid imposing defense costs on the taxpayers if any of the defendants are required to seek appointed counsel. Finally, Judge Kaplan held that the allegations stated a claim for contract implied in fact and, with the possible exception of one defendant whose claim may be subject to dismissal on summary judgment, the claims would proceed to trial. KPMG appealed the ruling.

### ***Recent Developments:***

On January 8, 2007, by invitation from the Second Circuit pursuant to Federal Rule of Appellate Procedure 21(b)(4), Judge Kaplan filed a 47-page brief urging the court to treat KPMG’s appeal as a petition for writ of mandamus. Judge Kaplan argued that the petition should be denied, as there was “little likelihood that the issue” would recur, and described the entire case as “the perfect storm.” Kaplan further argued that even if the Second Circuit considered the merits of the petition, his exercise of ancillary jurisdiction should be upheld pursuant to *Garcia v. Teitler*, 443 F.3d 202 (2<sup>nd</sup> Cir. 2006), and the three-part test set forth in *Kokkonen v. Guardian Life Insurance Co.*, 511 U.S. 375 (1994).

*United States v. Stein, et al.*, 2006 WL 3164781 (S.D.N.Y. 2006) (October 31, 2006) – Defendant David Makov moved for a severance on the ground that he could then obtain favorable testimony from his co-defendants John Larson and Robert Pfaff. The court denied the motion as untimely, having been filed more than 6 months after the deadline without a demonstration of good cause.

The court noted that, even if the motion were timely, it would be denied on the merits for failure to satisfy the factors set forth in *United States v. Finklestein*, 526 F.2d 517 (2<sup>nd</sup> Cir. 1975)

– (1) sufficiency of the showing that co-defendant would testify at a severed trial and waive his Fifth Amendment privilege; (2) degree to which the exculpatory testimony would be cumulative; (3) the counter argument of judicial economy; and (4) the extent to which the testimony would be subject to impeachment. *Id.* at 523-24. The court believed that the only way Larson and Pfaff would actually testify, and thereby risk their own defense, would be if they were tried first and acquitted. The court further noted that their affidavits, attached to Makov’s motion, did not demonstrate that they have personal knowledge of anything that would be admissible and not cumulative.

***United States v. Stein, et al.***, --- F.Supp.2d ---, 2006 WL 3327594 (S.D.N.Y. 2006) (November 13, 2006) – The government applied for six-month continuance on several grounds including defendants’ need for additional time to prepare for trial. The court noted that, following its determination of the government’s unconstitutional conduct in pressuring KPMG to cut off the defendants’ legal fees upon indicted, it had opted not to dismiss the indictments or impose other sanctions. Instead, the court decided to address the issue of legal fees, reasoning that if KPMG was obliged to pay and did so, the impact of the government’s improper conduct would be diminished. On the other hand, if either KPMG is not obliged to pay or a prompt determination was not feasible, the court would reconsider sanctions against the government.

Judge Kaplan recognized the severity of the legal fee issue, noting that the cost of a basic defense in this case could exceed a million dollars. Because it was apparent that the fee issue would not be resolved in time for the January 15, 2007 trial date, the court adjourned the trial *sine die*. The defendants were directed to produce their witness and exhibit lists and make their expert disclosures by March 1, 2007.

***United States v. Stein, et al.***, --- F.Supp.2d ---, 2006 WL 3486796 (S.D.N.Y. 2006) (December 4, 2006) – Defendant Carol Warley, moved to suppress statements she made to attorneys representing KPMG during the criminal investigation, which were produced to the government when KPMG waived its attorney-client privilege and executed a deferred prosecution agreement. Warley contends that the attorneys to whom she spoke represented her and KPMG, pointing to prior cases of joint representation and the KPMG partnership agreement, which provides “[t]he General Counsel shall act on behalf of all Members, except where a dispute arises between an individual Member and the Firm.” *Stein*, 2006 WL 3486796, at \*2.

Judge Kaplan noted the problems that arise when an employer’s counsel interviews employees and fails to specifically state that any statements are not subject to attorney-client privilege. The court noted that different standards applied by the federal courts to determine when personal attorney-client privilege between employer’s counsel and the employee attaches. *Stein*, 2006 WL 3486796, at \*2-4. An overriding theme was whether the communications between employer’s counsel and the employee involve personal matters of the employee, including the employee’s personal rights and liabilities.

Judge Kaplan considered Warley’s prior interaction with KPMG’s counsel, as well as the content of and circumstances surrounding the communications at issue. He ultimately held that Warley failed to satisfy her burden of establishing that a personal privilege applied. *Id.*, at \*4-5.

## 26 U.S.C. § 7201 (intent to evade or defeat tax)

In *United States v. Harris*, 2006 WL 2873398 (6<sup>th</sup> Cir. (Ohio)) (Oct. 10, 2006), Michael Kotula was convicted of conspiracy to defraud the IRS in violation of 18 U.S.C. § 371, and evasion in violation of 26 U.S.C. § 7201. The evasion charge stemmed from Kotula's treatment of a sale of property to Ashtabula County, Ohio, as subject to deferred taxation under 26 U.S.C. § 1033, due to the threat of eminent domain. County officials testified that they never threatened eminent domain and that the references thereto in the contract were inserted at Kotula's request.

Kotula requested that the jury be instructed that “[a] sale of property is made under threat of condemnation if the taxpayer has reasonable grounds to believe the property eventually will be condemned.” *Harris*, 2006 WL 2873398, at \*48. The district court instructed as follows:

If a taxpayer sells property to the government under threat of or imminence thereof of eminent domain, the taxpayer may defer reporting any capital gains incurred from the sale ..... Otherwise, any capital gains incurred from the sale of that property must be reported by the taxpayer the same tax year as the sale.

*Id.* Kotula appealed, arguing that the instruction was improper. He cited to Revenue Ruling 63-221, which provides that “a threat or imminence of eminent domain exists when ‘the property owner has reasonable grounds to believe ... that the necessary steps to condemn the property will be instituted if a voluntary sale is not arranged.’” *Id.* (citing *Murray v. Commissioner*, 1965 WL 1112 (Tax Ct. 1965), *aff'd*, 370 F.2d 568 (4<sup>th</sup> Cir. 1967)). Kotula also cited Revenue Ruling 81-180, which provides that “a sale to someone other than the potential eminent-domain authority also qualifies as a § 1033 deferred exchange if made by a ‘taxpayer having reasonable grounds to believe that the necessary steps to condemn the property eventually would have been instituted....’” *Harris*, 2006 WL 2873398, at \*48.

The Sixth Circuit rejected the government's argument that Revenue Rulings should be disregarded, noting that they “constitute precedents to be used in the disposition of other cases” and “serve as official interpretation[s] by the IRS of the tax laws.” *Id.* (citations omitted) Based on these rulings, the court agreed that the instruction given was “a prejudicially incomplete statement of the law” in that it “did not fairly and adequately submit [] the issues and applicable law to the jury.” *Id.* at 49 (quotations and citations omitted) The court further agreed that Kotula has been prejudiced by the error, but did not go so far as to accept Kotula's version of the instruction. The Sixth Circuit held that “[t]he district court should have instructed the jury that the issue is whether Kotula had a good-faith belief that there were reasonable grounds to fear that the county would exercise eminent domain.” *Id.* The court vacated and remanded for a new trial on the evasion count.

In *United States v. Torrance*, 2006 WL 3259116 (D. Conn.) (Nov. 9, 2006), Torrance was charged with evasion of payment through the filing of a false Offer in Compromise, in violation of 26 U.S.C. § 7201, and filing false statements based on his submission of false Collection Information Statements (Forms 433A and B), in violation of 26 U.S.C. § 7206(1). Torrance moved for a bill of particulars, arguing that it “is often necessary in criminal tax prosecutions because the government can use any one of multiple approaches to prove its case.”

*Torrance*, 2006 WL 3259116, at \*1. The government responded that while a bill of particulars may be necessary in evasion of assessment cases, it generally is not needed in evasion of payment cases. The court denied *Torrance*'s motion, finding that the indictment provided adequate information regarding the charges to allow *Torrance* to mount a defense, and that *Torrance* failed to establish that he would be prejudiced in the absence of additional information.

In *United States v. Boulware*, 470 F.3d 931 (9<sup>th</sup> Cir. 2006) (Dec. 13, 2006), *Boulware* was convicted – both in an original trial and on remand - of five counts of filing false returns in violation of 26 U.S.C. § 7206(1), four counts of tax evasion in violation of 26 U.S.C. § 7201, and one count of conspiracy to make false statements to a federally-insured financial institution in violation of 18 U.S.C. § 1014, stemming from his diversion of ten million dollars from his corporation, HIE. On remand, *Boulware* was sentenced to the same 36 months on the false return counts, but his sentence on the conspiracy count was increased from 51 to 60 months.

On appeal, *Boulware* argued, *inter alia*, that the district court erred in excluding evidence that the funds he received from HIE were nontaxable returns of capital rather than income. In excluding such evidence, the district court looked to *United States v. Miller*, 543 F.2d 1204, 1210-12 (9<sup>th</sup> Cir. 1976), which held “that constructive distribution rules applicable in the civil arena could not be automatically applied to a criminal tax matter in the absence of some demonstration . . . that distributions were intended to be a return of capital.” 470 F.3d at 933-34. The *Miller* court further held that “[w]here the taxpayer has sought to conceal income by filing a false return, he has violated the tax evasion statutes. It does not matter that that amount could have somehow been made nontaxable if the taxpayer had proceeded on a different course.” 543 F.2d at 1214. The Ninth Circuit declined to accept *Boulware*'s reliance on the decisions in *United States v. D'Agostino*, 145 F.3d 69, 72-73 (2<sup>nd</sup> Cir. 1998) and *United States v. Bok*, 156 F.3d 157, 162 (2<sup>nd</sup> Cir. 1998). In a concurring opinion, Circuit Judge Thomas agreed with the majority in light of *Miller*, but noted that “if we were writing on a clean slate, rather than under the controlling precedent of [*Miller*], I would adopt the approach of the Second Circuit concerning the return to capital defense.” 470 F.3d at 938.

### **26 U.S.C. § 7203 (failure to file)**

In *FEDEX Ground Package System v. Futch*, --- So.2d ---, 2006 WL 3422373 (Fla. App. 3 Dist.) (Nov. 29, 2006), the District Court of Appeal of Florida for the Third District held as a matter of first impression that a witness's prior convictions for failure to file tax returns in violation of 26 U.S.C. § 7203 were *not* admissible for impeachment. In reaching its decision, the court considered the federal circuit courts and courts in other states that had considered the issue and noted the lack of consensus.

The court rejected the holding in *United States v. Klein*, 438 F.Supp. 485, 487 (S.D.N.Y. 1977), which compared willful failure to file a tax return to a conviction for importing cocaine that involved a false statement to customs official, which the *Klein* court stated was admissible for impeachment according to the Second Circuit in *United States v. Hayes*, 553 F.2d 824, 827 (2<sup>nd</sup> Cir. 1977). The court disagreed that *Hayes* made any such holding, and disagreed that a failure to file was similar to the making of a false statement. The court also rejected *United States v. Gellman*, 677 F.2d 65, 66 (11<sup>th</sup> Cir. 1982), and *Zukowski v. Dunton*, 650 F.2d 30, 34 (4<sup>th</sup>

Cir. 1981), both of which relied on the *Klein* opinion. Instead, the court adopted the view set forth in *Cree v. Hatcher*, 969 F.2d 34, 37 (3<sup>rd</sup> Cir. 1992), where the Third Circuit barred the use of failure to file convictions for purposes of impeachment on the grounds that such crimes do not involve dishonesty.

In *United States v. Tanaka*, 2006 WL 3613203 (9<sup>th</sup> Cir. (Hawaii)) (Dec. 11, 2006), Tanaka was convicted of structuring transactions to evade currency reporting requirements in violation of 31 U.S.C. § 5324, and willful failure to file in violation of 26 U.S.C. § 7203. On appeal, Tanaka argued that the indictment should have been dismissed because the district court abused its discretion in allowing the government to impeach Tanaka with evidence of his prior tax conviction. The Ninth Circuit disagree, holding that failure to file a tax return is a crime involving dishonesty, which is “automatically admissible for impeachment purposes under Federal Rule of Evidence 609(a)(2), and no balancing of prejudice is required.” *Tanaka*, 2006 WL 3613203, at \* 1 (citing *Dean v. Trans World Airlines*, 924 F.2d 805, 811-12 (9<sup>th</sup> Cir. 1991)).

In *United States v. Andujar*, 2006 WL 3741843 (3d Cir. (N.J.)) (Dec. 20, 2006), Andujar was convicted of one count of bankruptcy fraud in violation of 18 U.S.C. § 152(3) and 22 counts of failure to file returns in violation of 26 U.S.C. § 7203. On appeal, Andujar argued that the district court abused its discretion under Federal Rules of Evidence 404(b) and 403 by admitting extensive evidence of Andujar’s tax filing history not charged in the indictment.

The district court admitted Andujar’s tax filing history as direct evidence of the crime charged and as evidence of willfulness under Rule 404(b). In affirming this decision, the Third Circuit considered its recent ruling in *United States v. Daraio*, 445 F.3d 253 (3<sup>rd</sup> Cir. 2006), in which it held that “[i]n cases involving violations of federal tax laws such as tax evasion, [a] defendant’s past taxpaying record is admissible to prove willfulness circumstantially.” *Id.* at 264 (quoting *United States v. Ringwalt*, 213 F.Supp.2d 499, 506 (E.D.Pa. 2002)). With regard to whether the probative value of the tax history evidence was substantially outweighed by undue prejudice, the Third Circuit found no abuse of discretion by the district court, noting that “the number of uncharged acts alleged, even if disproportionate to the number of charged acts, does not alone render admission of such evidence an abuse of discretion.” *Andujar*, 2006 WL 3741843, \*7 (quoting *United States v. Mathis*, 264 F.3d 321, 327 (3<sup>rd</sup> Cir. 2001)).

### **26 U.S.C. § 7206 (false statement)**

In *United States v. Black*, --- F. Supp.2d ---, 2006 WL 3797717 (N.D. Ill.) (Dec. 21, 2006), the defendants moved to dismiss charges for willfully procuring and assisting in the preparation of false and fraudulent corporate tax returns, on the grounds that the indictment failed to allege an essential element – that the fraudulent or false return was filed. Citing the elements of § 7206(2) as set forth by the Seventh Circuit in *United States v. Hooks*, 848 F.2d 785, 788-89 (7<sup>th</sup> Cir. 1988), the district court denied the motion, holding that the statute does not require that the return at issue actually be filed.

## 18 U.S.C. § 1503 (obstruction of justice)

In *United States v. DeAngelis*, 2006 WL 3082674 (11<sup>th</sup> Cir. (Fla.)) (Oct. 31, 2006), DeAngelis was convicted of 51 counts of conspiracy, wire fraud, mail fraud, money laundering, obstruction of justice, perjury, tax evasion, and identity theft offenses, all stemming from his solicitation of \$1.5 million from investors in his Velvet Hammer Consulting Group and GIASI (“Godley Inspired and Spiritually Invincible” or “God is Always Sitting In”) companies. DeAngelis used the investments to fund Ponzi payments and maintain his extravagant lifestyle.

DeAngelis appealed his 300-month sentence, arguing, *inter alia*, that the evidence was insufficient to support an obstruction of justice conviction, based on false statements he made to a pretrial services officer regarding his income and assets for purposes of a bond hearing. The Eleventh Circuit held that a bond hearing was a “judicial proceeding” for purposes of 18 U.S.C. § 1503, and affirmed the conviction. DeAngelis further argued that the evidence was insufficient to support his perjury conviction because the false statement he made to the pretrial services officer was not material, in that it did not affect his bond determination. The Eleventh Circuit again disagreed, noting that “[a] statement is material if it is capable of influencing the tribunal on the issue before it.” *DeAngelis*, 2006 WL 3082674, at \*4 (internal citation omitted). It found that the false information regarding DeAngelis’ assets could influence the court’s decision on fines or restitution and therefore, such statements were material.

### Sentencing Issues

**(calculation of loss)** - In *United States v. Roush, Jr.*, 466 F.3d 380 (5<sup>th</sup> Cir.) (Oct. 3, 2006), Roush received stock in February, 1998 as compensation for legal services he rendered. In September, Roush caused more than 20 million shares of the stock to be issued to six related entities. Roush did not report the stock as income in 1998 and did not file returns for the entities. He did, however, claim charitable contributions for donating over 4 million shares to John Marshall Law School.

Roush pled guilty to evasion, in violation of 26 U.S.C. § 7201. The government estimated the value of the stock upon receipt at \$3.4 million, with a corresponding tax loss of \$1,148,409 and a base offense level of 22. After enhancements and a reduction for acceptance of responsibility, the presentence report recommended of a total offense level of 23, resulting in an advisory guideline range of 46 to 57 months. At sentencing, the district court found that the PSR computation of loss “significantly overstates the actual seriousness of the offense,” 466 F.3d at 384, because the stock was subject to restrictions and was worthless by the end of 1998. Instead, the court used the value of Roush’s claimed contribution, applied the 39.6 percent tax bracket, and arrived at a total offense level of 21 and a guideline range of 37 to 46 months. The court then sentenced Roush to 27 months.

Roush appealed, arguing that the sentence was unreasonable since the stock was restricted at the time of receipt and worthless at the time he filed his returns. The Fifth Circuit disagreed, noting that because Roush had the right to request immediate issuance of the stock in February, 1998, he was in constructive receipt of the income and, pursuant to 26 U.S.C. § 83(a), was required to recognize income equal to the value of the shares at that time. The court also

rejected Roush's argument regarding the worthlessness of the stock at year end, and found that the district court's deviation from the advisory range based on this irrelevant and improper factor resulted in an unreasonable sentence.

The Fifth Circuit cautioned that it was not suggesting that "a non-guideline sentence for tax evasion must be scaled to the tax loss. To do so would improperly limit the district court's discretion in sentencing." 466 F.3d at 390. Instead, it simply held that any deviation must be properly justified by factors set forth in § 3553(a). Based on its finding that the sentence was unreasonable, the court vacated Roush's sentence and remanded for re-sentencing.

**(calculation of tax loss)** - In *United States v. Retherford*, 2006 WL 3095863 (10<sup>th</sup> Cir. (Colo.)) (Nov. 2, 2006), Retherford and his co-defendants were charged with one count of conspiring to defraud the United States by assisting in the preparation of false returns, in violation of 18 U.S.C. § 371; twenty-six counts of aiding and assisting in the preparation of false returns, in violation of 26 U.S.C. § 7206(2); one count of filing a false report with the Secretary of the Treasury, in violation of 31 U.S.C. § 5314; and one count of failing to provide financial information to the IRS, in violation of 31 U.S.C. § 5322. Retherford was convicted of the conspiracy count and one count of assisting in the preparation of a false return. The jury either acquitted or hung on the remaining counts.

The presentence report calculated the tax loss at \$3,132,259, based on the total loss arising from the conduct referenced in the indictment, including those for which Retherford was acquitted. The district court rejected Retherford's argument that the loss should be limited to the loss arising out of the single § 7206(1) count for which he was convicted. The court found by a preponderance of the evidence that Retherford was involved in the entire scheme referenced in the indictment, which involved taking taxpayers' income and creating false expenses, moving the income to offshore account, and falsely omitting the income on the taxpayers' returns. After considering the various enhancements suggested in the presentence report, the district court sentenced Retherford to a sentence of 48 months – below the advisory guideline range.

Retherford appealed, maintaining that the tax loss calculation was improper because the jury may have found that he conspired with his co-defendants only with respect to the one return that formed the basis of the substantive charge for which he was convicted. The Tenth Circuit rejected this argument, finding that it was based on Retherford's misunderstanding of the roles of the judge and the jury post-*Booker*. The court held that district judges can find the necessary facts to calculate the appropriate sentencing range using a preponderance of evidence standard as long as the Guidelines are applied in an advisory manner. The court also noted that, pursuant to U.S.S.G. § 1B1.3, Retherford could be held accountable for relevant conduct for which he had not been convicted.

**(§ 3553(a) factors)** - In *United States v. Repking*, 467 F.3d 1091 (7<sup>th</sup> Cir. 2006) (Nov. 7, 2006), Repking, president of a federally insured bank, pled guilty to making false entries in the bank's records, in violation of 18 U.S.C. § 1005, and filing a false tax return in violation of 26 U.S.C. § 7206(1), stemming from his embezzlement of bank funds. Repking's advisory guideline range was 41 to 51 months. The government moved for a departure for substantial assistance under U.S.S.G. § 5K1.1, and requested a sentence of 24 months. Repking sought a

reduced sentence based on his charitable contributions to the community. The district court sentenced Repking to one day of incarceration, three years supervised release and a fine of \$100,000. The court further ordered Repking to spend the first six months of his supervised release on home detention, and to perform 900 hours of community service.

The government appealed the sentence, arguing that it was unreasonable for a defendant whose advisory guideline range was 41 to 51 months, although it conceded at oral argument that the proper point of comparison was the 24 months it recommended at sentencing. The Seventh Circuit considered whether the sentence was supported by adequate reasons and was substantively reasonable. The court declined the government's invitation to assess the reasonableness of Repking's sentence in terms of the percentage by which it departs from the advisory range. *Repking*, 467 F.3d at 1095. Instead, the court looked to whether the district court's explanation for the sentence imposed was sufficiently proportional to the variance.

Upon review of the district court's oral and written reasons, the Seventh Circuit held that while it had sufficiently considered the factors set forth in § 3553(a), the resulting sentence was unreasonable. The court found that Repking's charitable works were not so extraordinary as to warrant a departure from the advisory guideline range and that the record failed to establish Repking's "extraordinary efforts" to make restitution. *Repking*, 467 F.3d at 1096 (citing *United States v. Filipiak*, 466 F.3d 582 (7<sup>th</sup> Cir. 2006)). Based on the foregoing, the Seventh Circuit vacated Repking's sentence and remanded for resentencing.

**(calculation of tax loss; sophisticated means)** – In *United States v. Jabbour*, 2006 WL 3369524 (11<sup>th</sup> Cir. (Fla.)) (Nov. 21, 2006), Jabbour was charged with 47 counts of a 51-count indictment involving a fraudulent investment and tax evasion scheme. At the beginning of trial, Jabbour pled guilty to count 49 – evasion of payment of his personal taxes in violation of 26 U.S.C. § 7201. Early in the trial, the government agreed to dismiss the charges against Jabbour if he pled guilty to two additional counts of evasion. The court rejected the plea. The jury found Jabbour guilty of one count of conspiring to impair and impede the IRS in violation of 18 U.S.C. § 371 and one count of evasion of payment of a co-conspirator's taxes in violation of 26 U.S.C. § 7201 and 18 U.S.C. § 2. In response to questions presented by the court, the jury found that Jabbour did not use sophisticated means, and tax loss was between \$80,001 and \$200,000.

At sentencing, the district court applied enhancements for sophisticated means, role in the offense and obstruction of justice. The court also increased the loss to \$1.632 million and denied a reduction for acceptance of responsibility. Using the resulting advisory guideline range of 108 to 135 months, the court sentenced Jabbour to 120 months.

On appeal, Jabbour argued that his sentence should be vacated because the sentences violated his rights under the Sixth Amendment and the Ex Post Facto Clause. He further argued that his sentence was unreasonable and the trial court was prejudiced against him. The Eleventh Circuit affirmed the sentence, stating that "the Sixth Amendment is violated only when extra-verdict enhancements yield a sentence that exceeds the statutory maximum authorized by the jury." *Jabbour*, 2006 WL 3369524, at \* 3 (citing *United States v. Booker*, 543 U.S. 220, 244 (2005)). The court rejected Jabbour's argument regarding the tax loss, noting that "[w]hen the amount of tax loss is uncertain, the guidelines contemplate that the court will simply make a

reasonable estimate based on the available facts.” *Jabbour*, 2006 WL 3369524, at \* 3 (quoting U.S.S.G. § 2T1.1, cmt. n. 1).

The court affirmed the district court’s rejection of the jury’s finding that Jabbour lacked sophisticated means. The Eleventh Circuit noted that “[s]o long as the sentence imposed does not exceed that authorized by the jury, a sentencing court is free to make its own findings by a preponderance of the evidence.” *Jabbour*, 2006 WL 3369524, at \*4. Finally, the court upheld the obstruction of justice enhancement, noting that Jabbour’s false testimony (as evidence by the guilty verdict) was a sufficient basis for such enhancement.

**(§ 3553(a) factors)** - In *United States v. Kitchin*, 2006 WL 3543574 (N.D. Ind.) (Dec. 8, 2006), Kitchin sold invalid/nonexistent third party athletic accident insurance, collecting premiums totaling between \$800,000 and \$1,500,000, and provided schools with false documents to continue the scheme. Kitchin’s victims included the athletes that were injured. In one case, a student was injured during practice and suffered quadriplegia. The student filed multiple claims for coverage with Kitchin’s company, all of which were denied. Kitchin pled guilty to one count of mail fraud in violation of 18 U.S.C. § 1341, and one count of willful failure to file, supply information or pay tax in violation of 26 U.S.C. § 7203. The district court calculated the advisory guideline range to be 27 to 33 months.

Kitchin requested a departure from the advisory range based on his medical condition. In May 1999 (after the offenses were committed), Kitchin was injured in an automobile accident resulting in (ironically) quadriplegia. He has no hand or leg function, but has limited use of his muscles in his arms. He requires extensive daily care, which Kitchin’s counsel videotaped in graphic detail and submitted to the court on five CD ROMS. After viewing the videos, the court agreed that the amount and quality of care Kitchin receives in his home is phenomenal.

The court reviewed the factors set forth in 18 U.S.C. § 3553(a) and agreed that Kitchin’s lack of criminal history, participation in youth organizations and current medical situation all weighed in his favor. However, the severity of his crime, the need for just punishment and for adequate deterrence prevented the court from granting Kitchin’s request for a departure. The court noted that the BOP, even after viewing the CD ROMS, indicated that it could provide adequate medical care for Kitchin during his incarceration. Ultimately, the court denied any departure from the guideline range.

**(abuse of position of trust; sophisticated means)** – In *United States v. Fife*, --- F. 3d ---, 2006 WL 3591261 (7<sup>th</sup> Cir. (Ind.)) (Dec. 12, 2006), Fife pled guilty to four counts of filing false returns in violation of 26 U.S.C. § 7206(1). His wife, Krahn, pled guilty to one count of willfully aiding and assisting in the preparation and presentation of false return in violation of 26 U.S.C. § 7206(2). The district court imposed a two-level enhancement for abuse of a position of trust against Fife, and two-level enhancements for sophisticated means against Fife and Krahn.

Fife was a lawyer and special assistant to the mayor of East Chicago, Indiana. In this capacity, Fife was responsible for consulting on a wide variety of matters on behalf of the city. Fife created shell entities which he used to contract with the city and obtain significant fees. Fife

did not file returns for the entities. Krahn created a separate shell corporation that also obtained fees from the city but provided nothing in return. Krahn did not file returns for her corporation.

The Seventh Circuit affirmed the abuse of a position trust enhancement, rejecting Fife's argument that such an enhancement is only proper if the victim – the United States – placed the defendant in the position of trust. *Fife*, 2006 WL 3591261, \*3 (citing *United States v. Stewart*, 33 F.3d 764, 769 (7<sup>th</sup> Cir. 1994)). The Seventh Circuit also disagreed that the scheme was not “sophisticated” since the shell corporations obtained employer identification numbers, thereby putting the Service on notice that returns should be expected. The court stated that the defendants were confusing “sophisticated” with “intelligent.” “The sophisticated means enhancement does not require a brilliant scheme, just one that displays a greater level of planning or concealment than the usual tax evasion case.” 2006 WL 3591261, at \*3 (citing *United States v. Kontny*, 238 F.3d 815, 821 (7<sup>th</sup> Cir. 2001)).

## Restitution

In *United States v. Mickle*, 464 F.3d 804 (8<sup>th</sup> Cir.) (Oct. 3, 2006), the Mickle brothers recruited persons to file fraudulent federal and state income tax returns and shared the improper refunds with their participants. The brothers pled guilty to one count of conspiring to defraud the United States with respect to false claims, in violation of 18 U.S.C. § 286, and four counts of aiding and abetting false claims against the United States, in violation of 18 U.S.C. § 287. As part of their sentences, the court imposed restitution to the State of Minnesota and the private financial institutions for the refunds and refund anticipation loans obtained in the scheme.

On appeal, the Mickle brothers argued that since the offense of conviction involved a conspiracy to defraud the United States, restitution should be limited to the federal government. The Eighth Circuit noted that the Mandatory Victims Restitution Act (“MVRA”) “authorizes an order of restitution to any person ‘directly and proximately harmed’ as a result of the conspiracy, even if the offense of conviction did not require proof of an agreement to defraud those particular victims.” *Mickle*, 464 F.3d at 810. The indictment alleged that the defendants conspired to obtain money from the United States, the State of Minnesota, and various financial institutions by filing false tax returns claiming false refunds. The Eighth Circuit affirmed the restitution order, finding that in their guilty plea, the defendants admitted to obtaining refunds from Minnesota and refund anticipation loans based on the false returns, thereby establishing that they directly and proximately caused the harm suffered by Minnesota and the private lenders.

In *United States v. Nolen*, --- F.3d ---, 2006 WL 3598522 (5<sup>th</sup> Cir. (Tex.)) (Dec. 12, 2006), Nolen was convicted on three counts of evasion in violation of 26 U.S.C. § 7201. The district court sentenced him to 37 months imprisonment, imposed a fine of \$60,000 and ordered him to pay restitution of \$435,275 pursuant to 18 U.S.C. § 3663. Among his issues on appeal, Nolen argued that restitution was not authorized by that statute.

The Fifth Circuit agreed, noting that restitution is only authorized under § 3663 if the defendant is convicted of an offense under Title 18 or Title 49. *Nolen*, 2006 WL 3598522, at \*15, n. 53. Moreover, restitution under § 3663 is limited to the loss associated with the counts of conviction, and not relevant conduct. *Id.* The Fifth Circuit acknowledged that “[r]estitution to

the IRS may be imposed as a condition of supervised release under § 3583, but only if ‘the specified sum of taxes ... has [] been acknowledged, conclusively established in the criminal proceeding, or finally determined in civil proceedings.’” *Nolen*, 2006 WL 3598522, \*15 and n. 54 (quoting *United States v. Touchet*, 658 F.2d 1074, 1076 (5<sup>th</sup> Cir. 1981)). Because Nolen’s tax liability was not conclusively established at trial, the court reversed the restitution order and remanded for resentencing.

In *United States v. Mayhew*, 2006 WL 3794327 (9th Cir. (Cal.)) (Dec. 19, 2006), Mayhew was indicted on six counts of filing false returns in violation of 26 U.S.C. § 7206(1). He pled guilty to one count pursuant to a plea agreement that included the following language: “The Court may order defendant to pay any additional taxes, interest and penalties that defendant owes to the United States.” The presentence report calculated the guideline range at 21 to 27 months. Pursuant to the plea, the government recommended a sentence of 24 months. The Court sentenced Mayhew to 36 months, in part due to his unwillingness to pay the taxes owed. The Court ordered Mayhew to pay \$642,195, the amount of referenced in the plea, and further ordered that payment was a condition of supervised release.

On appeal, Mayhew argued that his sentence was unreasonable because (1) the court erroneously considered his unwillingness to pay restitution in sentencing him above the advisory guidelines, (2) the court did not have authority to order him to pay back taxes, and (3) the court was not permitted to condition his supervised release on payment.

The Ninth Circuit agreed that courts are not permitted to order restitution in a false return case under 26 U.S.C. § 7206, unless it is by agreement of the parties. In this case, however, the restitution would be affirmed because the plea agreement specifically authorized the court to order Mayhew to pay back taxes, interest and penalties, rather than simply stating that the defendant would pay back taxes. Because the trial court was authorized to order restitution, it was not improper to make such restitution a condition of supervised release.

The Ninth Circuit also rejected Mayhew’s argument that the district court improperly sentenced him to the statutory maximum in order to obtain payment of the tax due. The court noted that 18 U.S.C. § 3553(a) provides that the trial court shall consider the need for restitution, as well as the need to promote respect for the law and afford deterrence. Mayhew’s reluctance to pay restitution was properly considered by the trial court in determining a reasonable sentence.

## **Miscellaneous**

**(Evidence)** - In *United States v. Wade*, 2006 WL 3059929 (10<sup>th</sup> Cir. (Utah)) (Oct. 30, 2006), Mr. and Mrs. Wade were charged with conspiring to defraud the United States in violation of 18 U.S.C. § 371 by using sham entities called Unincorporated Business Organizations (“UBOs” or “business trusts”) to hide income and avoid paying more than \$1.5 million in tax. The Wades were also charged with bankruptcy fraud in violation of 18 U.S.C. § 157, false statements in a bankruptcy case in violation of 18 U.S.C. § 152, and evasion of assessment and payment in violation of 26 U.S.C. § 7201. Mrs. Wade pled guilty. Mr. Wade was convicted of all charges following trial.

Among the many arguments raised by Mr. Wade on appeal was his contention that the district court erred in limiting the testimony of Daniel Hunter, and attorney and CPA who began representing Wade after the creation of the UBOs. Hunter was prepared to testify as to Wade's level of sophistication in the area of grantor trusts. The government successfully objected pursuant to Rule 701(b), arguing that Hunter's opinion of Wade was not helpful to understanding his testimony regarding advice given to Wade prior to filing bankruptcy. The Tenth Circuit agreed, holding that the district court did not abuse its discretion in limiting Hunter's testimony to his statement that the rules surrounding grantor trusts were very complicated and confusing.

Wade further argued that both he and Hunter should have been permitted to testify as to Wade's attempt to settle with the Service. The Tenth Circuit again affirmed the lower court, stating, "we fail to see how the attempts to settle the tax debt after the charged offenses are relevant to his conduct beforehand." *Wade*, 2006 WL 3059929, \* 7.

Finally, the Tenth Circuit rejected Wade's argument that the district court improperly permitted a Revenue Agent to testify as an expert summary witness. Wade did not dispute the agent's qualifications. Instead, he maintained that the agent improperly testified about the law, misstated the law, and improperly testified regarding Wade's mental state. The Tenth Circuit agreed that testimony on ultimate questions of law is not favored because it invades the province of the jury, *citing Specht v. Jensen*, 853 F.2d 805, 808 (10<sup>th</sup> Cir. 1988). However, the court noted that some reference to the law may be permissible, as long as the witness does not engage in a broad legal discourse. The court then adopted the position of the Seventh Circuit in *United States v. Windfelder*, 790 F.2d 576 (7<sup>th</sup> Cir. 1986), that "a properly qualified IRS agent may analyze a transaction and give expert testimony about its tax consequences but may not express an opinion about the defendant's state of mind at the time of the transaction." *Wade*, 2006 WL 3059929, at \*8 (*citing Windfelder*, 790 F.2d at 581-82). In light of the limiting jury instruction given by the district court, the Tenth Circuit found no error in the admission of the agent's testimony.

**(Motion to Quash)** - In *In re Grand Jury Subpoena Issued to Lewis Butler*, 2006 WL 3259102 (D. Conn.) (Nov. 9, 2006), Torrance, the defendant, moved for leave to intervene to file a motion to quash a grand jury subpoena issued to his accountant, after Torrance was indicted on one count of evasion of payment in violation of 26 U.S.C. § 7201, and two counts of filing false documents, in violation of 26 U.S.C. § 7206(1). Torrance argued that the subpoena was issued to obtain evidence for use in government's case against Torrance, an abuse of the grand jury process. The government countered that Torrance lacked standing to challenge the subpoena and that the subpoena was issued as part of an on-going investigation of other potential charges.

The district court acknowledged that a third party may intervene in the issuance of a grand jury subpoena if the third party has a substantial interest that could be impacted by the grand jury proceedings, such as constitutional rights or personal privileges. The district court further noted that while a grand jury has the power to issue post-indictment subpoenas, *United States v. R. Enters., Inc.*, 498 U.S. 292, 300-01 (1991), it may not use the grand jury to prepare for trial of a pending indictment, *citing United States v. Leung*, 40 F.3d 577, 581 (2<sup>nd</sup> Cir. 1994). Ultimately, the court found that Torrance established neither standing nor the invalidity of the

grand jury's activity, based in part on the government's *ex parte* sealed submission substantiating that the subpoena was part of an investigation that may lead to a superseding indictment.

**(Evidence)** - In *United States v. Milkiewicz*, 470 F.3d 390 (1<sup>st</sup> Cir. 2006) (Dec. 6, 2006), Milkiewicz was convicted of defrauding a federal court in violation of 18 U.S.C. § 371, by scheming with a court administrator to sell office supplies at inflated prices and to bill the court for supplies that were never delivered, presenting false claims for payment in violation of 18 U.S.C. § 287, and filing false returns in violation of 26 U.S.C. § 7206(1). Milkiewicz was sentenced to 41 months and ordered to pay restitution in the amount of \$196,796.63. Milkiewicz appealed, arguing that the district court improperly permitted the jury to consider summary charts during deliberations, and improperly relied on its own fact-finding for the restitution amount in violation of his rights under the Sixth Amendment.

The First Circuit took the opportunity to clarify its position with respect to summary exhibits admissible under Rules 611(a), 703 and 1006 of the Federal Rules of Evidence, providing a very helpful explanation of the various options when a party is faced with complex or voluminous evidence. The court ultimately determined that the summary charts were admissible and affirmed the district court's rulings.

With respect to restitution, notwithstanding its agreement that Milkiewicz's claim should be reviewed for plain error, having not been raised below, the court opted to fully address the impact of *United States v. Booker*, 543 U.S. 220 (2005), on restitution, to make clear that judicial fact-finding on restitution is permissible. In accordance with this discussion, the court found no error in the district court's restitution order.

**(5<sup>th</sup> Amendment)** - In *United States v. Murphy*, 469 F.3d 1130 (7<sup>th</sup> Cir. 2006) (Dec. 8, 2006), Murphy, a tax protestor and client of Anderson's Ark & Associates, was convicted of filing false returns in violation of 26 U.S.C. § 7206(1) and failure to file in violation of 26 U.S.C. § 7203. Murphy appealed, arguing that the district court committed reversible error when it denied him court-appointed counsel.

The Seventh Circuit began by noting that, "[d]uring the 10 months leading up to and including his trial, [Murphy] employed a pattern of delay and misdirection that would make an NFL offensive coordinator jealous." *Murphy*, 469 F.3d at 1132. In rejecting Murphy's argument, the court noted that Murphy had 9 months from the date of his arraignment to the start of trial to secure counsel or demonstrate his financial eligibility for appointed counsel. The district court even offered to seal any financial information Murphy provided for the purpose of obtaining appointed counsel, in an effort to protect his Fifth Amendment rights. Instead, Murphy engaged in a spirited pattern of delay to "game the system." Murphy's conviction was affirmed.

**(Dual criminality and specialty)** - In *United States v. Anderson*, --- F.3d ---, 2006 WL 3803167 (9<sup>th</sup> Cir.) (Dec. 28, 2006), Anderson was involved in Anderson's Ark and Associates (AAA), an organization designed to assist taxpayers in avoiding income taxes. In 1999, Anderson moved to Costa Rica and in 2001, petitioned for naturalized Costa Rican citizenship. While the petition was pending, the United States charged Anderson with conspiracy to defraud in violation of 18 U.S.C. § 371, and obtained a warrant for his arrest.

In early 2002, Anderson was detained in Costa Rica and the United States filed a formal request for extradition. While the request was pending, Anderson's Costa Rican citizenship petition was granted. Three weeks later, a Costa Rican court granted the extradition request and soon thereafter, the Costa Rican government annulled Anderson's citizenship. Anderson filed appeals, but was soon transported to Miami and then to Seattle to face what would become a 102 count indictment. Anderson was convicted of conspiring to defraud the United States, aiding and assisting the filing of false returns, conspiring to commit mail and wire fraud and money laundering, as well as substantive counts of mail fraud, wire fraud and money laundering.

On appeal, Anderson argued that his convictions for money laundering and conspiracy to commit money laundering should be vacated under the doctrine of dual criminality, which requires that a defendant be extradited only if the alleged offenses are considered criminal under both the surrendering and requesting nations, and the doctrine of specialty, which bars the prosecution of an extradited defendant for offenses other than those for which he has been extradited. Because money laundering is only a crime in Costa Rica if it involves funds derived from drug trafficking, and there is no such allegation in the indictment, Anderson contends that the money laundering counts must be dismissed. Anderson further contends that the United States violated the doctrine of specialty by charging him with money laundering offenses after Costa Rica held that it would not extradite him on money laundering charges, and after the United States agreed not to prosecute on any charges other than those approved by the Costa Rican court.

The Ninth Circuit agreed that if the laundered funds were not connected to drug trafficking, the government would be precluded from prosecuting those charges. It remanded the case, stating that if the district court agreed that the principles of dual criminality and specialty were violated, the proper remedy was to vacate the convictions on those counts and resentence.